

# HOUSE BILL REPORT

## ESSB 6885

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### As Passed House - Amended:

March 2, 2006

**Title:** An act relating to unemployment insurance.

**Brief Description:** Modifying unemployment insurance provisions.

**Sponsors:** By Senate Committee on Labor, Commerce, Research & Development (originally sponsored by Senators Kohl-Welles, McAuliffe, Thibaudeau, Keiser and Fairley).

### Brief History:

#### Committee Activity:

Commerce & Labor: 2/20/06, 2/22/06 [DP].

#### Floor Activity:

Passed House - Amended: 3/2/06, 97-1.

### Brief Summary of Engrossed Substitute Bill (As Amended by House)

- Retains the weekly benefit using "two quarter averaging" and a 3.85 percent multiplier.
- Retains liberal construction of the unemployment compensation law.
- Modifies the voluntary quit provisions applicable to mandatory military transfers.
- Retains noncharging of benefits that exceed the amount that would have been paid if benefits were based on 1 percent of annual wages.
- Makes the social cost factor zero through rate year 2007 and makes the maximum tax rate 5.7 percent beginning in rate year 2008 for certain seasonal industries.
- Depending on the trust fund balance, reduces the flat social cost factor rate and changes the solvency surcharge trigger.
- Reenacts and makes retroactive certain provisions of 2ESB 6097 (Laws of 2003, 2nd Sp. S., Chapter 4).

- Requires the Employment Security Department to study and report to the Legislature by December 1, 2006, on: (1) repeat episodes of unemployment; (2) rate class 40 employers; (3) employer turnover; and (4) fraud prevention methods.

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## HOUSE COMMITTEE ON COMMERCE & LABOR

**Majority Report:** Do pass. Signed by 5 members: Representatives Conway, Chair; Wood, Vice Chair; Hudgins, Kenney and McCoy.

**Minority Report:** Do not pass. Signed by 4 members: Representatives Condotta, Ranking Minority Member; Chandler, Assistant Ranking Minority Member; Crouse and Holmquist.

**Staff:** Jill Reinmuth (786-7134) and Chris Cordes (786-7103).

### **Background:**

The unemployment compensation system is designed and intended to provide partial wage replacement for workers who are unemployed through no fault of their own. Eligible unemployed workers receive benefits based on their earnings in their base year. Most covered employers pay contributions (payroll taxes) to finance benefits.

In 2003, and again in 2005, the Legislature enacted a number of changes to the unemployment insurance system. The changes included revisions to unemployment benefits and taxes.

### **I. Benefits**

An individual is eligible to receive regular benefits if he or she: (1) worked at least 680 hours in his or her base year; (2) was separated from employment through no fault of his or her own or quit work for good cause; and (3) is able to work and is actively seeking employment. Regular benefits are based on the individual's earnings in his or her base year; they are not based on financial need.

#### **A. Weekly Benefit Amount**

Prior to the 2003 legislation, a claimant's weekly benefit amount (WBA) was calculated using 4 percent of the claimant's average wages in the two quarters of the base year in which wages were highest ("two quarter averaging").

The 2003 legislation modified the formula used to calculate the WBA as follows:

- *On or after January 4, 2004, and before January 2, 2005:* The WBA was calculated using 4 percent of the claimant's average wages in the three quarters of the base year in which wages were highest ("three quarter averaging").
- *On or after January 2, 2005:* The WBA was 1 percent of the claimant's total wages in the base year ("four quarter averaging").

The 2005 legislation further modified the formula used to calculate the WBA as follows:

- *On or after April 24, 2005, and before July 1, 2007:* The WBA is calculated using 3.85 percent of the claimant's average wages in the two quarters of the base year in which wages were highest ("two quarter averaging").

## **B. "Good Cause" Quits**

Individuals are disqualified from receiving benefits if they leave work voluntarily without good cause.

Prior to the 2003 legislation, there were a variety of reasons considered to be good cause for leaving work voluntarily. One reason was to relocate for a spouse's employer-initiated mandatory job transfer.

The 2003 legislation limited the reasons considered to be good cause for leaving work voluntarily. One reason is to relocate for a spouse's mandatory military transfer, so long as the relocation is to a state that similarly does not consider the individual to have left work without good cause.

## **C. Construction**

Prior to the 2003 legislation, the Employment Security Act was to be liberally construed to reduce involuntary unemployment to the minimum. The 2003 legislation repealed this requirement. The 2005 legislation restored this requirement until June 30, 2007.

## **II. Contributions**

Contributions are payroll taxes used to finance unemployment compensation benefits. Most private employers are required to pay contributions. The amounts of the contributions are based on the tax rate assigned to the employer and the taxable wage base.

### **A. Tax Rates**

The 2003 legislation specified that the tax rate for most covered employers is determined by the combined array calculation factor rate and the social cost factor rate, subject to a maximum rate, and a solvency surcharge, if any. These rates are determined as follows:

- *Array calculation factor:* Employers are placed in one of 40 rate classes, with rates from 0 percent to 5.4 percent. The assigned rate class depends on the employer's layoff experience.
- *Social cost factor:* A flat social cost rate is calculated as the difference between benefits paid and taxes paid, divided by total taxable payroll. The amount is then adjusted for the months of benefits in the trust fund above 10 months, but the rate may not be less than 0.6 percent. Employers pay a graduated social cost factor rate, ranging from 78 percent to 120 percent of the flat rate, depending on the employer's rate class.
- *Maximum rate for the sum of the array calculation factor and the social cost factor:* For employers in fishing, agriculture, and food and seafood processing, the maximum rate is 6 percent. For employers in all other industries, the maximum rate is 6.5 percent.

- *Solvency surcharge*: Up to an additional 0.2 percent surcharge is added to the contribution rate in the next rate year if the unemployment trust fund has fewer than six months of benefits on a specified annual date.

The 2005 legislation made adjustments to the social cost factor as follows:

- For fiscal years 2006 and 2007, the social cost factor rate is zero for employers in agricultural crops, livestock, agricultural services, food and seafood processing, fishing, and cold storage.
- For tax rate year 2007, the flat social cost factor is the lesser of the rate applicable with the new WBA calculations in effect or the rate that would have been applicable if the WBA had been calculated as 1 percent of a claimant's annual wages.
- The formula is adjusted for determining the social cost factor in rate year 2007 to account for benefits that are not effectively charged because of these changes in the social cost factor.

## **B. Experience Rating**

Most benefits paid to claimants are charged to their base year employers' accounts. Some benefits, however, are pooled costs within the system and are generally referred to as socialized costs.

The 2005 legislation specified that certain benefits not be charged and that certain socialized costs be paid with certain funds. Beginning in Fiscal Year 2006 and through Fiscal Year 2007, benefits paid that exceed the benefits that would have been paid if the weekly benefit amount had been calculated as 1 percent of a claimant's annual wages are not charged. In addition, funds are first requisitioned from the Reed Act funds in the amount of the benefits that are not effectively charged because the social cost factor rate is reduced to zero for certain industries and in the amount of benefits paid that exceed the benefits that would have been paid if the weekly benefit amount had been calculated as 1 percent of a claimant's annual wages.

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## **Summary of Amended Bill:**

The following revisions to unemployment benefits and taxes are made.

### **I. Benefits**

#### **A. Weekly Benefit Amount**

The language expiring "two quarter averaging" is removed. The formula specifying that the weekly benefit amount be calculated using 3.85 percent of the claimant's average wages in the two quarters of the base year in which wages were highest is made permanent.

#### **B. "Good Cause" Quits**

The language limiting good cause quits for mandatory military transfers is removed. One reason considered to be good cause is to relocate for the spouse's mandatory military transfer, regardless of where the individual relocates.

### **C. Construction**

The provision expiring the liberal construction requirement is repealed. The requirement that the Employment Security Act be liberally construed to reduce involuntary unemployment to the minimum is made permanent.

## **II. Taxes**

### **A. Tax Rates**

The method used to reduce the flat social cost factor rate (under which the rate is reduced depending on the trust fund balance) is modified as follows:

*If at least 10 months but less than 12 months of benefits are in the fund:* The maximum reduction is 0.4 and the minimum rate is 0.6 percent.

*If at least 12 months but less than 14 months of benefits are in the fund:* The maximum reduction is 0.4 and the minimum rate is 0.5 percent.

*If 14 or more months of benefits are in the fund:* The maximum reduction is 0.4 and the minimum rate is 0.45 percent for employers in rate class 1 and 0.5 percent for all other employers

The expiration date for the "zero" graduated social cost factor rate for employers in agricultural crops, livestock, agricultural services, food and seafood processing, fishing, and cold storage is changed from June 30, 2007, to December 31, 2007.

Various changes in the calculation of the social cost factor rate that applied only to rate year 2007 are deleted.

The maximum tax rate for employers in agricultural crops, livestock, agricultural services, food and seafood processing, fishing, and cold storage is changed to 5.7 percent, beginning in rate year 2008.

The solvency tax applies only if the trust fund balance has fewer than seven months of benefits rather than six months of benefits.

### **B. Experience Rating**

The language expiring the noncharging of benefits paid that exceed the benefits that would have been paid if the weekly benefit amount had been calculated as 1 percent of a claimant's annual wages is removed. The noncharging of these benefits is made permanent.

The language specifying that, in fiscal year 2007, Reed Act funds are requisitioned to pay certain benefits is removed. Requisitions of Reed Act funds to pay certain benefits end after fiscal year 2006.

### III. Other

Certain provisions of the 2003 legislation are reenacted and made retroactive as specified. These provisions relate to definitions ("wages"), covered employment (service by nonresident aliens), continuing eligibility for benefits (work search pursuant to customary trade practices, suitable work for part-time workers, and job search monitoring), disqualification from benefits (misconduct and gross misconduct), and administration (uses of funds).

The Employment Security Department must study the following: (1) employment patterns involving repeat episodes of unemployment; (2) employers in rate class 40; (3) reasons for the high employer turnover; and (4) fraud prevention methods. The Department must report its findings to the Unemployment Insurance Advisory Committee and legislative committees by December 1, 2006.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** The bill contains an emergency clause and takes effect immediately.

**Testimony For:** This bill adopts all reasonable recommendations made by Dr. Wayne Vroman to the task force. It balances interests in lowering unemployment insurance costs, achieving benefit equity, and maintaining a healthy and solvent trust fund.

When you compare this bill and Second Engrossed Senate Bill 6097 (2ESB 6097) with respect to costs and benefits, you will find that it brings us somewhere in the middle.

The bill leaves us in the mainstream concerning two quarter averaging. It follows Dr. Vroman's highest recommendation, which was restoring two quarter averaging. The Legislature can permanently restore two quarter averaging, and still achieve substantial savings. The wage replacement rate for a majority of workers will be about 50 percent, which is the national standard.

The bill leaves us without further discriminatory practices. It makes one small change to ensure that military families are treated in the same manner, regardless of which state they are transferred to. Quit to follow protection keeps families together.

The bill restores liberal construction, which is both a national standard and a bedrock principle of the unemployment insurance system. When interpreting an unemployment insurance law, it is a moral imperative to interpret the statute in a manner to reduce involuntary unemployment and ease suffering.

The bill includes tax changes suggested by the Employment Security Department. It lowers the taxable wage based to 75 percent of the average annual wage, which lowers the tax cap on high wage employers. It smooths the social cost rate by using four years of costs instead of one year. It provides for a variable flat social cost tax rate so that, when the trust fund is high,

the social tax goes down. It helps small employers who only pay social costs. It lowers the maximum total tax rate for agriculture and fishing from 6 percent to 5.7 percent. It also changes the trigger for the solvency surcharge from six months to eight months, which ensures that the trust fund stays healthy. The cumulative cost savings will be \$1.5 billion between 2006 and 2014.

There are currently excess funds in the Unemployment Insurance Trust Fund. In past years, we have had similar circumstances and have made changes, like adopting the AA tax schedule, to drain funds out of the fund. Substitute Senate Bill 6885 does the same thing, partly by increasing benefits and partly by decreasing taxes.

The data runs have been done and have been broken down by North American Industry Classification System codes (NAICS codes). The runs show reductions in all of the rate classes.

The construction industry is different. Construction workers are always working themselves out of a job. When contractors get a bid, they inflate crews. As soon as the work is done, they need to lay off the crews and get the workers off the payroll. Unlike workers in other industries, workers in the construction industry do not exhaust available benefits. They draw benefits for a shorter time. Under an experience-rated system, unemployment rates for contractors go up. It is difficult for contractors to have workers available when they need them and not pay unemployment insurance when workers are laid off.

When 2ESB 6097 was enacted, the savings were unknown. Now, the savings are known. The savings includes \$93 million from freezing the maximum benefit amount, \$43 million from freezing the number of weeks, \$24 million from voluntary quit denials, and \$25 million from administrative changes. When Engrossed House Bill 2255 was enacted, there was still a net savings of \$47 million from reducing the multiplier and restoring two-quarter averaging. Overall, that is more than \$200 million in savings.

2ESB 6097 created a more experience-rated system and decreased socialized costs. It is important to keep in mind that the majority of 2ESB 6097 stays in place. There are only two other states with equal or better experience rating than Washington.

Washington has a long history of always having a higher unemployment rate than the rest of the country. There should be a recognition that, because there will be higher unemployment in Washington, there should be a more generous system. Everyone, not just unemployed workers, rely on the system in bad times.

There should be a focus on people who are getting benefits that they are not entitled to and employers who are not paying the taxes that they are supposed to. No one who is entitled to benefits should be denied, and no one who is not entitled should get one red cent. It is better to use a scalpel to cut out the employers or employees who are gaming the system rather than saying we are too lazy to figure it out.

Labor made huge concessions in 2003. Workers lost their homes, had their power shut off, and suffered in other ways. Labor compromised by going to a 3.85 percent multiplier even though the unemployment insurance system could handle a 4.0 percent multiplier.

Policies that penalize repeat claimants who, through no fault of their own, are laid off year after year should not be implemented. Such a policy would undermine the viability of Washington's agricultural industry. Agricultural workers rely on unemployment insurance when they do not have employment. Latino business owners also suffer from reductions in benefits paid to agricultural workers.

Community colleges are repeat users of part-time faculty, and therefore, part-time faculty members use unemployment insurance. It is the only way these faculty members can continue teaching.

(Neutral) The Employment Security Department's highest priority is to protect the solvency of the trust fund and to provide a system where unemployed workers are adequately supported in tough times, businesses pay their fair share, and the system does not whipsaw back and forth every year, creating confusion for workers and businesses.

The trust fund is doing unexpectedly and surprisingly well. If taxes and benefits are not brought into balance, the trust fund will grow by billions in the next few years. The U.S. Department of Labor recommends having 12 months of benefits in the trust fund. In 2005, Washington had 15 months. In 2014, Washington will have 20 months or more. These amounts are greater than necessary to keep the trust fund solvent.

The benefits and taxes in the system need to be brought back into alignment. The question for the Legislature is how to allocate excess reserve funds to restore balance to system. The fairest approach is to do a little of both. According to our analysis, the trust fund will continue to be solvent even if benefits are increased and taxes are reduced.

It is imperative to pass something this year to avoid reprogramming computers twice in the next 16 months. If changes are not made until 2007, the agency will have to work for six months to make the changes for the sunset of the 2005 legislation, and then make additional changes for the 2007 legislation. The agency would waste months of work and millions of dollars.

**Testimony Against:** As written now, SSB 6885 lowers the balance in the trust fund more and more each year. It slowly spends down the savings to fund increased benefits. In a recession, it spends down the savings to six months of benefits, which business and labor have agreed is too low. It disguises a draw down of the trust fund as a tax break. SSB 6855 talks about savings, but out in 2014, the system still does not balance. Benefits are still greater than taxes, so the system never appears to stabilize.

The most troubling factor is the lack of data, and the only available data shows the system not balancing out. There is not any data that breaks down the effects of SSB 6885 by industry level. The available data shows that unemployment insurance costs in Washington continue to be twice the national average.

The task force has not finished its work. It has not yet taken Dr. Vroman's recommendations and come up with a proposal. A reasonable approach is within our grasp. A situation where business can put a proposal on the table is close. The Legislature should give business and labor time to come up with a reasonable solution. The Legislature has until the middle of next year to act. It is not necessary to act this year.

SSB 6885 is neither a solution nor a compromise. It will only increase costs and shift the burden among industry. A fair, long-term solution is needed so that the Legislature does not come back to this issue year after year.

SSB 6885 is unfair. Benefits will be the same for full-time workers as part-time workers. Some workers will get twice as much as others that earn the same amount. Taxes will shift from some employers to other employers. Some businesses will subsidize others. This proposal does not assure solvency or stability.

We are contemplating the fifth change in six years. Yearly changes are frustrating for business and for labor. We want to come up with a solution that lets us leave this system alone for awhile. We want a solution that results in stability and predictability.

For the food industry, SSB 6885 will result in lower worker benefits and increased employer costs. Benefits will be increased for higher-paid construction workers and decreased for UFCW grocery workers. Benefits will be increased for seasonal workers over year-round workers. It will take the food industry back to the conditions that existed prior to enactment of the 2003 reforms. At that time, a significant part of our taxes went towards paying other employers' costs.

The construction industry is a high cost industry. Layoffs are not unexpected. When the job is done, the workers are laid off. Employers know that and pay a good wage to the workers. Year after year, the same people are receiving benefits. In 2003 we tried to do something about the repeat situation, and in 2006 we still need to do something about it.

The construction industry agreed to the changes in 2ESB 6097, knowing that the tax rate would go up. However, there was another side of that coin and that has now been removed. The construction industry will stay at the same tax rate under SSB 6885, and will not cover its own costs. Other industries will pay for the construction industry's costs, and that is not equitable. Seasonal workers will be paid the same as year-round, stable workers, and that is not equitable.

More than 60 percent of the fishing industry is currently in rate class 40 and, no matter what they do, they will stay in rate class 40. The fishing industry needs relief. SSB 6885 does not provide it. The fishing industry was promised an opportunity to deal with seasonality the next time that the issue of unemployment insurance came up.

Unemployment insurance is among the top five problems faced by small business. These changes greatly decrease the ability of small businesses to provide other benefits. Thousands of small businesses are paying more than they cost the system. SSB 6885 only increases that

problem. It creates more socialized costs, and does not provide a seasonal fix. It also restores liberal construction, which makes decisions biased in favor of the employee.

Small business is not being heard. Our small business needs to hire two more employees to handle our increased volume, but the cost of unemployment taxes per employee is too high to hire additional staff. Please give very careful thought to the ramifications of the proposed changes for companies like ours. Please let the parties work towards a true compromise.

There is a win-win approach if both sides are willing to give a little. One way is to pay benefits using two quarter averaging and a 3.67 percent multiplier, charge benefits using four quarter averaging and a 4.0 percent multiplier, and add a buy down factor when the trust fund is ten months or grater. This proposal could restore 92 percent of benefits that were reduced by moving from two quarter averaging to four quarter averaging. The difference is about \$120 million in benefits versus tax payments. We can each take an equal share in covering that difference. We can pay that difference through social taxes and buy downs. For example, there could be a reduction in the social tax, a requirement for 1.5 high quarter earnings with increased hours, a fishing industry opt-in, or a limit on high-wage reciprocity. These options show that we can come up with solution with a little bit of give from everyone.

**Persons Testifying:** (In support) Owen Linch, Joint Council of Teamsters Local 28; Dave Johnson, Washington State Building and Construction Trades Council; Joe Crump, United Food and Commercial Workers; Jeff Johnson, Washington State Labor Council; Bob Abbott, Washington and Northern Idaho District Council of Laborers; Pamela Crone, Unemployment Law Project and Amalgamated Transit Unit; Eric Nicholson, United Farm Workers; Geraldo Rios; Richard King, International Brotherhood of Electrical Workers; John Lowell, Northwest Carpenters Union; and Phil Jack, American Federation of Teachers.

(Neutral) Karen Lee and Annette Copeland, Employment Security Department.

(Opposed) Mellani McAleenan, Association of Washington Business; Judy Coover, Printcom, Inc.; Clif Finch, Washington Food Industry; Jim Fenton, QFC; Larry Stevens, National Electrical Contractors Association and Mechanical Contractors Association; Gina Bacigalupo, National Electrical Contractors Association; Rick Slunaker, Associated General Contractors; Ed Owens, Coalition of Coastal Fisheries and Purse Seine Vessels' Owners Association; Carolyn Logue, National Federation of Independent Business; Mark Johnson, Washington Retail Association; Gary Smith, Independent Business Association; Bruce Beckett, Weyerhaeuser; and Brian Minnich, Building Industry Association of Washington.

**Persons Signed In To Testify But Not Testifying:** (In support) Pastor Mejia, United Farm Workers; Richard Korn, Northwest Carpenters Union; and Lee Newgent, Bob DaPrato, and Jamie Maygra, Ironworkers Union Local 29.

(Opposed) Dan Fazio, Washington State Farm Bureau.